ARIZONA CORPORATION COMMISSION

DATE: JANUARY 21, 1998

DOCKET NOS: T-01072A-97-0067 and T-01072A-97-0028

TO ALL PARTIES:

Enclosed please find the recommendation of Hearing Officer Scott Wakefield. The recommendation has been filed in the form of an Opinion and Order on:

SOUTHWESTERN TELEPHONE COMPANY
(RATE INCREASE)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Hearing Officer by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

JANUARY 30, 1998

The enclosed is NOT an order of the Commission, but a recommendation of the Hearing Officer to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

FEBRUARY 2, 1998 and FEBRUARY 3, 1998

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250.

Jack Rose

JACK ROSE
EXECUTIVE SECRETARY

TO ALL PARTIES:

The Exhibit A price list will be provided under separate cover.

1200 WEST WASHINGTON; PHOENIX, ARIZONA 85007-2996 / 400 WEST CONGRESS STREET, TUCSON, ARIZONA 85701-1347

BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
COMMISSIONER - CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN TELEPHONE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO PROVIDE SUCH RATE OF RETURN.	DOCKET NO. T-01072A-97-0067
IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN TELEPHONE COMPANY TO REVISE ITS LOCAL EXCHANGE TARIFF.	DOCKET NO. T-01072A-97-0028 DECISION NO. ___________ **OPINION AND ORDER**

DATES OF HEARING: October 9, 10, and 14, 1997

PLACE OF HEARING: Phoenix, Arizona

PRESIDING OFFICER: Scott S. Wakefield

APPEARANCES:

SNELL & WILMER, L.L.P., by Messrs. Jeffrey W. Crockett and Thomas L. Mumaw, on behalf of Southwestern Telephone Company;

BEUS, GILBERT & MORRILL, P.L.L.C., by Mr. Martin A. Aronson, on behalf of GCB Communications, Inc.;

Mr. Stephen Gibelli, Staff Attorney, on behalf of the Residential Utility Consumer Office; and

Ms. Karen Nally, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Southwestern Telephone Company ("Southwestern", "Applicant" or "Company") is an Arizona corporation engaged in the business of providing telephone utility service to the public in a portion of La Paz County, Arizona. On January 10, 1997, the Arizona Corporation Commission ("Commission") received from Southwestern an application requesting authority to increase its rates and charges. On February 10, 1997, the Commission's Utilities Division Staff ("Staff") determined that Southwestern's application was sufficient. Our March 5, 1997 Procedural Order set the matter for hearing on October 9, 1997.

The Residential Utility Consumer Office ("RUCO"), AT&T Communications of the Mountain States, Inc. ("AT&T") and GCB Communications, Inc. ("GCB") requested and were granted intervention in the rate proceeding. AT&T subsequently filed a notice that it would not be participating in the matter.

On February 13, 1997, Southwestern submitted a tariff filing to the Commission in response to FCC Docket No. 96-128, relating to deregulation of payphone equipment ("Payphone Tariff Filing"). On April 15, 1997, the Commission issued Decision No. 60134, which approved the tariff as filed, subject to true-up within 180 days. On October 8, 1997, the Payphone Tariff Filing was consolidated with the rate case and the true-up period was extended until an Order was issued in the rate case.

The consolidated matter came before a duly authorized Hearing Officer of the Commission at the Commission's offices in Phoenix, Arizona beginning on October 9, 1997. Southwestern, RUCO, GCB and Staff appeared through counsel. At the conclusion of the hearing, the matter was adjourned pending submission of simultaneous initial and reply briefs on November 10, and November 24, 1997, respectively.

DISCUSSION

I. NATURE OF APPLICANT'S OPERATIONS AND PROPOSED INCREASES

Southwestern is an Arizona corporation engaged in the business of providing local telecommunications services to a total of approximately 4,000 access lines in the Quartzsite and Salome Exchanges in La Paz County pursuant to the authority of the Commission. The Company and its predecessors have provided local phone service to the area since the 1930's. Southwestern's existing rates were established in 1967.

In January 1995, Southwestern was acquired by TDS Telecom ("TDS"). This is Southwestern's first rate application since being acquired by TDS. Certain functions, including billing, accounting, engineering, human resources and regulatory affairs, which were previously performed by Southwestern's staff, are now performed by TDS or its affiliates. In addition, TDS provides an after-hours answering service for immediate response to after-hours customer inquiries.

Southwestern's application is based on a test year ("TY") ending March 31, 1996. In its application, Southwestern requested an increase in operating revenues of approximately $557,250, or 51.84 percent of its proposed intrastate revenues of $1,074,900. During the course of the proceeding, Southwestern revised its request to approximately $394,341, or a 32.37 percent increase based on revised TY intrastate revenues of $1,218,209. Staff recommended a decrease in operating revenues of $346,779, or 22.24 percent of its proposed intrastate revenues of $1,559,039. RUCO recommended an increase in operating revenues of no more than $368,294, or 33.73 percent of its proposed intrastate revenues of $1,091,821. Unless otherwise noted, all amounts stated throughout this Decision are on an intrastate basis.

II. RATE BASE

In its application, the Company proposed an original cost rate base ("OCRB") of $1,791,543. Staff and RUCO proposed adjustments which resulted in OCRBs of $1,680,896 and $1,720,020, respectively.

A. Deferred Income Tax

Both Staff and RUCO proposed adjustments to rate base to reflect accumulated deferred income taxes. The Company had included an income tax deferral in its capital structure. Staff and RUCO testified that the Commission historically has not included deferrals in the capital structure calculation, but does include deferrals as a reduction to rate base. The Company agreed with such treatment of its deferred income taxes. Staff proposed a resulting decrease of $175,232 to rate base, based on a 48.90 percent intrastate allocation factor. RUCO proposed a decrease of $175,483, based on an allocation factor of 48.97 percent. The Company did not dispute either proposed adjustment, and specifically accepted Staff's proposed decrease of $175,232. We will adopt Staff's adjustment.

B. Post-TY Plant to Provide Equal Access

Between December 1996 and January 1997, the Company converted to equal access. Equal access allows customers to presubscribe to a long distance carrier and complete toll calls by dialing "1" plus the telephone number, rather than by dialing a string of numbers to access their toll carrier of choice, plus the telephone number. Both Staff and RUCO proposed certain post-TY revenue adjustments due to the implementation of equal access. In conjunction with those adjustments, Staff and RUCO proposed adjustments to rate base to recognize the costs of equipment added after the TY, which was necessary to implement equal access. The Company identified an intrastate investment of $103,960 required to implement equal access. RUCO proposed a rate base increase of that amount. Staff proposed an increase of $64,585, which represents 8/12ths of the $103,960, and depreciation on the $103,960 for eight months. Staff apportioned the amounts for eight months because its revenue adjustment to recognize the effects of equal access was based on actual revenues in certain affected accounts for the eight months following the implementation of equal access. We believe it is proper to adjust rate base as Staff proposed because, below, we adjust the Company's revenues based on only eight months of actual data of equal access experience. We therefore will adjust rate base by $64,585.

C. Payphone Deregulation

Pursuant to several Orders in FCC Docket 96-128, payphone rates are to be deregulated and the investment, revenues and expenses relating to the provision of payphone services are to be removed from a local exchange carrier's cost of service. Southwestern proposed certain adjustments to remove from its application amounts related to payphone service. Staff concurred with those adjustments. We adopt the Company's proposed adjustment of ($7,069) to rate base.

D. Rate Base Summary

Based on the foregoing, the following statement details the adjusted TY OCRB for ratemaking purposes:

Rate Base (per Southwestern)	$ 1,791,543
Commission-approved adjustments	
Deferred Income Tax	($175,232)
Equal Access Plant	$64,585
Payphone Equipment	($7,069)
Rate Base (per Commission)	$1,673,827

The Company did not propose any reconstruction cost new rate base amounts. Therefore, we find the above-described OCRB to be the adjusted Fair Value Rate Base ("FVRB") for the TY.

III. OPERATING INCOME

A. Gross Annual Revenues

The Company had total actual revenues during the TY of $2,949,905, from which it made pro-forma adjustments, reducing it to $2,435,493. According to the application, the intrastate portion of those revenues was $1,074,900. Staff and RUCO proposed several additional adjustments.

1. Uncontested Revenue Adjustments

Staff proposed to adjust the Company's revenues by $46,802 to reflect revenues earned during the TY but recorded after the TY. The Company concurred that the adjustment was proper, but indicated that, due to a math error, the correct amount should be $49,802. Staff clarified that, in the text of its pre-filed testimony, it had made a typographical error, but indicated that the error had not been made it its schedules, and the $46,802 was the correct amount for the adjustment. We concur with the adjustment as originally proposed by Staff.

RUCO proposed an adjustment to revenues of $3,663 to correct an error on the Company's application. The Company concurred with the adjustment. We agree.

Staff and the Company agreed that coin service revenues resulting from the Company's operation of its payphones should be removed. During the TY, the Company recognized coin service revenue of $1,933, which we will remove from TY revenues.

2. Access Line Growth

The Company experiences significant seasonality in its customer base. To minimize the effect of that seasonality, the Company's application presented revenues based on the average number of access lines for the TY, rather than for the end-of-period number of access lines. Both Staff and RUCO proposed adjustments to annualize Company's revenues to end-of-period levels, to match the Company's use of an end-of-period rate base. The Company agreed that an annualizing adjustment was appropriate, but disagreed with the amounts of the proposed adjustments. Staff's $14,530 adjustment is based on an average growth rate over the three year period ending with the TY. RUCO proposed an adjustment of $13,258, which is based on the average number of units served from October 1995 (six months before the end of the TY) through September 1996 (six months after the end of the TY). The Company proposed an adjustment of $13,471, which is based on a compound growth rate for the past three years.

Staff's approach computes a growth rate comparing total additional access lines over the three year period to the number of access lines in the first year only. The Company's approach, however, computes a single growth rate, which, if applied to each of the three years, results in overall growth matching the actual growth which the Company experienced over that time. We believe that the Company's approach to computing the growth rate is more appropriate. We therefore adopt the Company's adjustment of $13,471.

3. Equal Access and Other Revenues

Staff presented evidence that the Company's total (inter- and intrastate) revenues increased by $1,068,228, or 43.86 percent, between the end of the TY and the year ended August 31, 1997. Staff identified four accounts with significant revenue increases in that time period, and proposed a revenue adjustment of $553,755 (intrastate). More than three-fourths of the revenue adjustment proposed by Staff ($424,288) can be attributed to the Company's conversion to equal access after the end of the TY. The remaining increase proposed by Staff ($129,467) relates primarily to the increased use of custom calling services (call forwarding, call waiting, etc.). Staff argued that not recognizing these dramatic increases in revenues would reward the Company for choosing a TY that is not representative of ongoing conditions. Staff also proposed corresponding adjustments to rate base, depreciation expense, and income taxes, as discussed elsewhere in this Decision.

RUCO's proposed adjustment recognized only a portion of the revenue increases identified by Staff. RUCO indicated that the increased revenue resulting from the implementation of equal access is attributable to an increase in usage of access services, and to an increase in the access rates the Company was able to charge. Upon the implementation of equal access, Southwestern was permitted to begin charging toll carriers premium rates for access, which were higher than the rates charged for access during the TY.[1] Southwestern also experienced an increase in the minutes of use of access services after equal access was implemented. RUCO proposed adjusting the Company's revenues for the revenue increase attributable to the Company charging the premium access rates, applied only to the TY minutes of use. RUCO argued that the Commission's practice is to adjust revenues for known and measurable changes, such as the impact of a rate increase, but not to reflect increases in sales volume occurring after the end of the TY. RUCO's resulting adjustment is $79,373. RUCO also proposed a corresponding adjustment to rate base, as discussed above.

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[1] AT&T was already receiving the equivalent of equal access, and thus its access rates were not affected by the implementation of equal access for other toll carriers.

The Company agrees with RUCO's proposed adjustment. The Company criticized Staff's proposed adjustment as contrary to the TY principle. The Company argued that, prior to the filing of the application, Staff had indicated that the TY ending March 31, 1996 would be acceptable. In addition, Staff had 30 days following the submission of the application to review the filing and determine whether it was sufficient. Staff did not raise any objection to the TY at that time. The Company objects to Staff arguing that large adjustments are necessary because the TY does not adequately represent the conditions that the Company will face when new rates are implemented.

The Company also argued that, if the Commission did adjust for revenues as Staff proposed, it should also recognize a decline in toll revenues of $125,815 between the end of the TY and August 1997. Staff disagreed, and indicated that the decline in toll revenues is attributable to the fact that, in October 1996, the Company reclassified long distance network services revenues to miscellaneous revenues.

Our decision whether to adopt a pro-forma adjustment involves three considerations: 1) Is the change known? 2) Is the amount of the change measurable with reasonable certainty? 3) Can its inclusion as a pro-forma adjustment be readily reconciled with the analysis of TY accounts without creating serious possibilities of distorting or mismatching? See Decision No. 53237 (September 30, 1982). All parties agree that an adjustment is necessary to reflect the increased "price" change which the Company effected upon implementing equal access. Contrary to RUCO's argument, however, not all "volume" adjustments should be denied. When known and measurable "volume" adjustments do not raise serious problems of mismatching, an adjustment is also appropriate to reflect the change in volume. Decision No. 53849 (December 22, 1983).

The parties agree, and we concur, that a pro-forma adjustment should be made for the increased access rates which the Company began charging upon the implementation of equal access. The change is known and measurable. With corresponding adjustments to rate base and depreciation expenses to reflect the installation of the additional plant required to implement equal access, mismatching is avoided.

The "volume" change relating to equal access should also be recognized with an appropriate adjustment. The change in volume is also known and measurable. No mismatching of revenues and rate base will result, because an adjustment to rate base was made to reflect the addition of the plant required to implement equal access. In fact, adjusting for the change in "price," with the corresponding rate base adjustment, without adjusting for the change in "volume" would create mismatching of revenues and rate base. We therefore will adopt Staff's proposed adjustment of $424,288 relating to the implementation of equal access.

We reject the remainder of Staff's proposed adjustment, relating to increased use of custom calling services and other revenues. Staff offered no explanation as to why the increase occurred, or whether the Company could expect to continue to experience similar revenue levels in the future. Unlike the increase in access revenues, which can be easily attributed to the implementation of equal access, no explanation was offered as to why the Company experienced this increase in custom calling and other revenues. Though the change in revenues may be measurable, without some reasonable explanation for the increase (e.g. post-TY promotional efforts/discounts to increase use of these services), we do not believe it satisfies the "known" prong of the standard set forth in Decision No. 53237. Further, Staff made no attempt to match any increased expenses which may have been either a cause or effect of the increase in revenues. We therefore will adjust the Company's revenue by $424,288.

B. Operating Revenues Summary

Intrastate Operating Revenues (per Southwestern)	$ 1,074,900
Commission-approved adjustments	
Revenue Recognized Post-TY	$46,802
Error in Application	$3,663
Coin Service Revenues	($1,933)
Access Line Growth	$13,471
Equal Access Revenues	$424,288
Intrastate Operating Revenues (per Commission)	$1,561,191

C. Annual Operating Expenses

Based on its application, the Company had total actual TY operating expenses of $2,935,844, which it adjusted by ($461,415) to $2,474,429. According to the application, the intrastate portion of those expenses was $1,241,545. RUCO and Staff recommended numerous adjustments to Southwestern's proposed operating expenses. For the reasons set forth hereinafter, we find that for ratemaking purposes, the TY intrastate operating expenses were $1,377,853.

1. Adjustments Agreed to by Southwestern

Southwestern agreed to adjust expenses by ($50,179), as follows:

- Expenses should be reduced by $7,293 to reflect the termination of the Desert

Gardens lease;

- Public relations expenses of $3,553 should be removed;
- Employee bonuses of $13,974 should be excluded;
- Non-recurring charges of $9,750 should be excluded, which related to the loading of Southwestern's financial statements at TDS, the purchase of a TV, VCR and stand for training purposes, and the purchase of an advertising banner;
- Penalties and Fines of $122 should be removed;
- Expenses should be reduced by $2,514 to remove the return portion of charges from the Company's affiliates;
- Expenses of $2,607 relating to an affiliate's acquisitions and cellular development should be removed; and
- Payphone-related expenses of $10,366 should be removed.

2. Affiliated Transactions and other expense increases

The Company was acquired by TDS in January 1995, and this is the Company's first rate case since that time. Staff indicated that the Company's expenses have increased 42.33 percent under TDS's management. During the TY, the Company received services from affiliated companies which, after adjustment by the Company, totaled $671,640 (inter- and intrastate). Staff argued that affiliate transactions which lack arm-length bargaining must be scrutinized more closely, and that the utility bears the burden of demonstrating that the affiliate transactions are reasonable and prudent. See Decision 58927 at 55, 56 (January 3, 1995).

Staff compared the Company's TY operating expenses with its average 1993 and 1994 operating expenses (the last two calendar years prior to acquisition by TDS), and noted that plant non-specific expenses had increased 116.91 percent and customer operations expenses had increased 134.67 percent.[2] Staff argued that ratepayers should expect that when TDS acquired the Company, operating expenses would decrease, or at least not increase, due to economies of scale. Staff therefore proposed that plant non-specific expenses and customer operations expenses be adjusted to their average 1993/1994 levels. Staff's proposed adjustment is ($231,633).

The Company opposed Staff's proposed adjustment for several reasons. First, the Company

[2] Both of these increases were computed on a total intra- and interstate basis.

argued that the adjustment should be rejected because Staff could not identify any particular invoices that represented unreasonable plant non-specific or customer operations expenses. Second, the Company claimed that Staff's adjustment is internally inconsistent, because Staff did not propose adjustments for other expense accounts which also had increases in the same time period, and because the adjustment Staff proposed included all increases in the two accounts, whether or not they were related to affiliate transactions. The Company contended that Staff is disallowing more than just the affiliated transaction portion of the plant non-specific and customer operations expenses.

Third, the Company argued that Staff made no allowance for other factors that could account for cost increases in the plant non-specific and customer operations expenses. The Company indicated that access lines increased 25 percent during the time period Staff considered in its adjustment. The Company proposed, and RUCO agreed, that the increase in access lines would explain at least a part of the cost increases which Staff is proposing to disallow. The Company also alleged that Staff ignored service improvements, including computerized billing and bill inquiry service, monthly accounting reports to management, employee training programs and a reduction in held service order times from 21 days to 1.5 days. Finally, the Company presented evidence that its per-line expenses compare favorably with other telephone companies.

Over 27 percent of the Company's total expenses are transactions with affiliates. As Staff has argued, affiliated transactions merit an increased level of review, because the transactions are not arms-length, and may be unreasonable. If Staff had proposed that only affiliate transactions be disallowed, the above-stated standard of review would apply. But Staff's proposed adjustment, though labeled as one, is not an affiliated transaction adjustment. Staff's proposed adjustment disallows the increased amount of expense for <u>all</u> transactions in the plant non-specific and customer operations accounts, regardless of whether the underlying transactions were with affiliates or not. Had Staff presented evidence of specific affiliated transactions which it opposed, we would review those transactions with the appropriately increased scrutiny. However, because Staff's proposed adjustment is not limited to affiliated transactions, we must apply our normal level of review.

Merely demonstrating that expenses have increased since the Company came under new ownership is not sufficient evidence to establish that the expenses were unreasonable. We concur with

Staff that increased expenses exceeding 100 percent does require some additional explanation. We believe that increases of those magnitudes are reasonable in this case based on the legitimate improvements in service which the Company has achieved,[3] and by the fact that the Company's per-line expenses are comparable to those of other telephone companies of similar size. We will not adopt Staff's proposed adjustment.

3. Labor Expense

Due to the transfer of certain tasks to the TDS corporate offices and affiliates, Southwestern was able to decrease the number of its employees during the TY. As of the beginning of the TY, Southwestern employed 23 people. By the end of the TY, Southwestern had 20 employees. Two of those employees had been reduced from full time to part time approximately three and six months into the TY. Since the end of the TY, three more employees have left the Company. One was a customer service representative, and the other two were part-time custodians. The Company has indicated that it does not intend to replace those three employees.

Staff and RUCO each proposed adjustments to reflect the decrease in the number of employees. Staff computed its ($29,996) adjustment by annualizing the March 1996 labor expense that is based on the end-of-TY number of employees. The Company concurred with this adjustment. RUCO used a different methodology to compute its ($34,121) adjustment. RUCO removed the payroll expenses to reflect the five positions that were vacated during the TY and the two positions which were switched from full to part time, and reflected a full year of payroll expense for the two part-time positions added during the TY. RUCO also removed the payroll expenses for the customer service position which was vacated after the TY. RUCO did not remove the custodians' payroll expenses, because it was unsure whether the Company had subsequently retained an outside firm to perform custodial services.

Staff's and RUCO's adjustments differ in that RUCO adjusted payroll for the post-TY departure of the customer service representative, while Staff did not. In addition, the Company argued that RUCO used the average separations factor for all operating expense rather than the specific intrastate allocation factor for labor. The Company also criticized RUCO's adjustment for failing to recognize that a portion

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3 We recognize, however, that some of those increases in service were achieved at no cost to the Company (*e.g.* expanded office hours resulting from flexible scheduling of employees).

of its labor costs are capitalized rather than expensed. RUCO's witness' exhibits detailing his adjustment, however, clearly indicate that his computations used only the amounts which were actually expensed.

RUCO's adjustment recognizes both the annualization of TY payroll expenses to end-of-period levels, and a known and measurable change in payroll expense occurring after the TY. We will accept RUCO's adjustment, with a minor modification to apply the labor-specific allocation factor. The resulting adjustment is a $34,031 decrease in labor expense.

4. Manager's Salary Expense

Staff proposed an adjustment of ($6,034) to reflect the capitalization of a portion of the Company manager's salary. Southwestern had not capitalized any of the manager's salary. Staff argued that a portion of the manager's time is spent on capital activities, and the Company's expense/capitalization ratio of 79.67/20.33 should be applied to the manager's salary. The Company responded that its manager is not responsible for network activities or capital projects, which are performed by affiliates, and therefore none of the manager's salary should be capitalized.

Staff has not convinced us that it is appropriate to capitalize a portion of the manager's salary. Therefore, no adjustment is necessary.

5. Payroll Tax Expense

RUCO proposed a reduction in payroll tax expense of $3,045, based on its proposed payroll expense adjustment and the agreed-to bonus adjustments. We believe that an adjustment to payroll expense is necessary in light of the adjustments we have made to payroll expense and bonuses. Though we modified RUCO's payroll expense and bonus adjustments slightly by using a different separations factor, RUCO's payroll tax expense adjustment used the proper separations and factor and needs no further adjustment. We adopt RUCO's full adjustment of ($3,045).

6. Relocation Expenses

In its application, the Company included relocation expenses of $20,282, which relate to the relocation of the Company manager from Oklahoma to Arizona. RUCO initially opposed the entire expense, because the Company had not incurred relocation expenses previously and was unlikely to incur them on an annual basis, due to the small number of employees. Staff proposed that the expense be recovered over a five year period, because it believed that a new manager usually makes the biggest impact during the first five years of employment. The Company responded by proposing a three year amortization period, because it expects that it will incur more relocation costs in the future due to opportunities in the TDS system. RUCO then proposed amortization over six years, the same period it proposed for amortization of the Company's rate case costs.

We will adopt Staff's proposed adjustment to amortize the Company's relocation costs over a five year period. The Company has only 17 employees, so it is unlikely that it will incur relocation expenses in the near future. We believe that 5 years is a reasonable term over which to allocate the relocation costs the Company incurred in the TY. The resulting adjustment is a decrease in expenses of $9,328.

7. Business Meals

Staff proposed a $473 adjustment to remove the full cost of business meals which the Company's manager had with employees. The Company provided no reason why the business could not have been conducted without the meals, and Staff believes that conducting business over a meal is not very efficient or productive. We reject Staff's blanket disallowance. Absent some showing that the meals were excessive or not in fact related to legitimate Company business, we will permit their recovery in rates.

8. Demonstration/Selling Expenses

Staff proposed an adjustment of ($17,402) to remove all of the Company's demonstration and selling expenses. The expenses relate to promotional items in bill inserts and brochures, marketing department expenses while working on promotional activities, and sales awards. The purpose of the selling activities is to increase customer awareness of new products and services and lead to increased revenues for the Company. Staff believes that shareholders are the primary beneficiaries of promotional activities, and therefore proposed that the expenses be removed from the cost of service. The Company responded that all customers benefit from increased revenues, in the form of lower rates for basic services. Both customers and shareholders benefit from increased revenues resulting from advertising. We will therefore split the demonstration and selling expenses between them. The resulting adjustment is a $8,701 decrease to the expense item.

9. USTA Dues

Staff proposed a disallowance of a portion of the Company's dues in the United States Telephone

Association ("USTA"). Staff contends that the portion of the USTA dues attributable to direct legislative and regulatory advocacy and research, public relations, contributions and club dues, litigation, and meals and entertainment should be removed from recoverable expenses. Staff's proposed adjustment is ($1,101).

The Company agreed that the portion of the dues ($139) attributable to public relations, contributions and club dues, and meals and entertainment should be disallowed. The Company noted that in Decision No. 55228 (October 9, 1986), the Commission allowed recovery of the trade and industry association dues, except for "government affairs" and advertising costs. Similar treatment here, the Company argued, would require disallowance of only another $442, attributable to direct legislative advocacy, and would require allowance of the remainder of the USTA dues.

We agree with Staff that expenses for legislative advocacy, legislative non-advocacy, regulatory advocacy, other regulatory activities, and litigation should be disallowed. We have historically disallowed trade association dues relating to lobbying efforts. Decision No. 55228 (October 9, 1986), Decision No. 58419 (September 30, 1993). We see no distinction between lobbying efforts directed to legislative and administrative bodies. Nor are expenses incurred for research and analysis of proposed legislative and regulatory actions, or litigation expenses incurred in appealing legislative or administrative actions, any more appropriate costs to pass along to ratepayers. All the expenses related to USTA lobbying, preparing to lobby, or appealing unsuccessful lobbying efforts should be disallowed. We therefore adopt Staff's entire adjustment of ($1,101).

10. Christmas Party

Staff proposed an adjustment to reduce employee activity expenses by $460 to remove the costs of the Company's Christmas party. Staff believes that the expense does not provide any benefits to ratepayers and may force some ratepayers to fund a religious activity to which they are opposed. The Company responded that the Christmas party benefits ratepayers by building employee morale. We will allow recovery of the expense, as it is minor and could reasonably be expected to boost morale among employees.

11. Uncollectible accounts

The Company's application included uncollectible accounts expense of 0.5 percent of revenues, based on its recorded bad debts from April 1995 through March 1996. Staff argued that the Company's accounting for bad debts expense is haphazard, and therefore its TY bad debt expense skews its actual bad debt experience. During the 27 months from January 1995 to March 1997, the Company recorded bad debts only six times. Staff indicated that the Company's bad debt expense during calendar year 1995 was .37 percent, and during calendar year 1996 was .3546 percent. Staff therefore adjusted the Company's bad debts expense to the 1996 rate, as it believes that amount is more representative of the Company's true bad debt experience. The resulting adjustment is a decrease of $1,563 in bad debts expense.

We agree with Staff that the Company's haphazard recording of bad debts resulted in a TY bad debt expense which was not representative of actual conditions. The Company made no change in debt collection procedures which would account for a decrease in uncollectible account expenses. Actual bad debt experiences over time are known and measurable. In addition to the ($1,563) adjustment proposed by Staff, we will also adjust an additional ($1,724) based on the adjustments to revenues recognized above, resulting in a total adjustment of ($3,287).

12. <u>Rate Case Expenses</u>

In its application, the Company amortized its estimated $60,000 rate case expenses over a three year period. Staff raised no objection to the Company's proposed amortization. RUCO, however, proposed an adjustment to recover the expenses over six years. RUCO's witness testified that non-Bell telephone companies in Arizona have experienced lengthy periods without rate cases. The Company has not filed a rate case in all the years of its existence. Its sister company, Arizona Telephone Company, is operating under rates established in 1972.[4] Citizens Utilities Company's last rate case for its existing telephone operations occurred in 1988, almost ten years ago.

The Telecommunications Act of 1996 has initiated massive changes in an effort to deregulate the telecommunications industry. In light of the move to a competitive environment, we concur with the Company and Staff that a three year amortization of rate case expenses is reasonable. No adjustment is necessary.

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[4] We note, however, that Arizona Telephone Company currently has a rate application pending.

13. Charges from other Affiliates

RUCO proposed an adjustment of ($5,429) to remove charges from an affiliate, Oklahoma Communications Systems, Inc., for Ronnie Brookover, who is now the Company's manager, and Chris Daft, who is now the Area Manager for Arizona Operations at TDS. The Company agreed to the adjustment with respect to charges relating to Mr. Brookover, as his annualized salary has been included in the application. The Company contended that the charges relating to Mr. Daft are appropriate, as he began performing work relating to the Company before relocating from Oklahoma to Arizona. We concur with the Company that charges relating to Mr. Daft should not be disallowed merely because he was located in Oklahoma at the time he performed work on behalf of the Company. The appropriate adjustment for charges relating to Mr. Brookover is ($893).

14. Depreciation Expense

Staff and RUCO each proposed adjustments to depreciation expense to reflect depreciation on the equipment necessary to implement equal access. As RUCO and Staff had proposed different adjustments to rate base to reflect the additional plant, their proposed adjustments varied. Above, we adopted Staff's adjustment to rate base to recognize the equal access plant. We therefore adopt Staff's corresponding depreciation expense adjustment of $7,100.

15. Synchronized Interest/Income Taxes

The parties agree that an adjustment to synchronize interest with rate base and the cost of capital is appropriate. Their disagreements on rate base, discussed above, and capital structure, discussed below, result in different adjustments in order to synchronize the Company's interest expense. We address the underlying disagreements in other sections of this Order. The required adjustment to synchronize interest, based on the conclusions we reach on the underlying issues, is $1,644.

The Company's application included a state income tax rate of 9.0 percent. RUCO indicated that the Arizona effective income tax rate is 8.257 percent, because income taxes accrued are deductible in determining Arizona taxable income. The Company agreed to this portion of the adjustment.

The Company used a 35 percent federal income tax rate in its application. RUCO indicated that federal taxes should be computed as if the Company were a stand-alone entity, and the resulting tax rate would be 34 percent for a corporation with the Company's revenues. The Company indicated that it files a consolidated tax return with TDS, and the resulting federal income tax is 35 percent. We concur with RUCO that income taxes should be computed on a stand-alone basis. Ratepayers should not bear the burden of a higher tax rate resulting from TDS's decision to file a consolidated tax return. An increase of $5,473 is necessary to adjust income taxes on the income/loss the Company stated in its application. A further adjustment of $232,656 is necessary to reflect the tax implication of the revenue and expense adjustments adopted herein. Including the $1,644 to synchronize interest, our total adjustment to income taxes is $239,773.

D. Statement of Net Operating Income

Based on the foregoing, the following statement details the adjusted TY net operating income for ratemaking purposes:

Operating Revenues	$1,561,191
Operating Expenses (per Application)	$1,241,545
Commission-approved Adjustments	
Settled Issues	($50,179)
Labor Expenses	($34,031)
Payroll Tax	($3,045)
Relocation Expense	($9,328)
Demonstration/Selling Expense	($8,701)
USTA Dues	($1,101)
Uncollectible Accounts	($3,287)
Charges from Affiliate - Brookover	($893)
Depreciation Expense	$7,100
Synchronize Interest/Income Taxes	$239,773
Total Operating Expenses	$1,377,853
Net Operating Income	$183,338

IV. RATE OF RETURN

Witnesses from Staff, RUCO and Southwestern presented cost of capital analyses to be considered as evidence by the Commission in determining a fair value rate of return for purposes of these proceedings. In its application, the Company proposed a weighted cost of capital of 9.00 percent. Staff's witness, Mr. Carlson, concluded that 10.01 percent is a reasonable rate of return for Southwestern. The Company adopted Staff's proposed cost of capital. RUCO's witness Mr. Larkin presented testimony supporting a 9.10 percent rate of return.

A. Capital Structure

Southwestern's actual capital structure at March 31, 1996 and the configurations recommended by the parties are as follows:

	3/31/96	Staff/Southwestern	RUCO
Short-Term Debt	21.17%	0.00%	22.88%
Long-Term Debt	23.36%	32.73%	25.24%
Preferred Stock	0.06%	0.09%	0.07%
Common Equity	47.95%	67.18%	51.81%
Income Tax Deferral	7.45%	0.00%	0.00%

As discussed above, Staff and RUCO both proposed removing accumulated deferred income taxes from the capital structure, and instead deducting it from rate base. The Company agreed to that treatment.

In addition, Staff proposed that the Commission adopt a capital structure which does not include short-term debt. Arizona Revised Statutes § 40-302(D) requires that a public service corporation obtain approval from the Commission for short-term debt in excess of seven percent of its capital structure. The Company has not sought or received approval of short-term debt in excess of that amount. Staff therefore believes that the Company's short-term debt should not be considered in this proceeding. The Company concurred with Staff's proposed capital structure.

RUCO's witness questioned whether the requirement of A.R.S. § 40-302(D) applies to Southwestern, arguing that the Company's parent company is not required to obtain Commission approval to issue short- or long-term debt, and the Company's capital structure is simply an allocation of its parent's capital structure[5]. In addition, RUCO's witness did not believe that 20 percent short-term debt is unreasonable for a small division of a large national telecommunications firm.

We disagree with Staff's proposal to disregard short-term debt in the Company's capital structure. Based on the overall testimony presented, we believe that the capital structure proposed by RUCO is appropriate.

B. Cost of Debt

The Company's actual cost of short-term debt was 8.75 percent. RUCO, however, proposed that

[5] RUCO's testimony on this issue was conflicting. At one point, RUCO's witness, Mr. Larkin, testified that the capital structure of TDS is attributed to the Company, but elsewhere Mr. Larkin testified that the Company's short-term debt is based on loans from its parent.

a cost of 6.00 percent be used, because, under normal market conditions, the cost of new short-term debt should be less than the cost of new long-term debt. The Company's long-term debts (except for a small truck loan from GMAC) have rates ranging from 6.6 percent to 8.0 percent. RUCO's witness testified that recent interest rates for commercial paper of 30-, 60- and 90-day periods are 5.55 percent. Further, the 12-month high and low interest rates for 90-day commercial paper have been 5.77 percent and 5.37 percent. RUCO therefore believes that a 6 percent cost of short-term debt is reasonable.

The Company responded that its originally-proposed 8.75 percent cost of short-term debt is based on a TY prime rate of 8.25 percent, plus a 0.5 percent premium. It disagreed that it would have access to large sources of unsecured capital, other than through its parent company, because all of its plant assets are pledged as collateral against its long-term debt. The Company therefore believes that the 8.75 percent rate is appropriate.

We will approve a cost of short-term debt of 7.50 percent. Though the Company has obtained its short-term funds from its parent company at 8.75 percent, that is not an arms-length transaction. The Company made the decision to use short-term debt rather than long-term debt. The ratepayers should not be penalized for that decision by the application of a higher-than-market cost. We will therefore approve a short-term debt cost of no more than 7.5 percent, the long-term debt rate which we adopt below.

The Company's actual cost of long-term debt has a weighted average cost of 7.5 percent. All parties agreed that this was an appropriate cost of long-term debt. We concur.

C. Cost of Preferred Stock

In its application, the Company indicated that its preferred stock has a non-cumulative dividend obligation of 9.0 percent. Staff proposed, however, that the Company's preferred stock be considered to have no cost, because the Company has indicated that TDS has not and will not pay any preferred dividends. The Company concurred with Staff's proposed treatment of preferred stock. We agree that, if the Company expects to pay no dividend on its preferred stock, it should be included at no cost.

D. Cost of Common Equity

The Company proposed a cost of equity of 11.25 percent. Both Staff and RUCO agreed with the Company's proposal. We will adopt 11.25 percent as the cost of equity.

E. Cost of Capital Summary

	Percentage	Cost	Weighted Cost
Short-term debt	22.88%	7.50%	1.716%
Long-term debt	25.24%	7.50%	1.893%
Preferred stock	0.07%	0.00%	0.000%
Common equity	51.81%	11.25%	5.829%
TOTAL			**9.438%**

V. GROSS REVENUE CONVERSION FACTOR

The Company initially proposed a gross revenue conversion factor of 1.7000 for use in computing the revenue increase required based on its operating deficiency. RUCO proposed a gross revenue conversion factor of 1.6598, which resulted from the use of different income tax rates (as discussed above) that the Company had used. Above, we adopted RUCO's approach to income tax calculations. We therefore adopt RUCO's proposed gross revenue conversion factor of 1.6598.

VI. AUTHORIZED INCREASE/DECREASE

With the adjustments adopted herein, the adjusted TY operating income is $183.338. Further, the 9.438 percent cost of capital is a reasonable rate of return on FVRB as authorized hereinabove. Multiplying the 9.438 percent rate of return by the FVRB produced required operating income of $157,976. This is $25,362 less than the Company's TY adjusted operating income. Multiplying the excess by the revenue conversion factor of 1.6598 results in a decrease in revenues of $42,096 or a 2.70 percent net decrease over TY adjusted revenues.

VII. RATE DESIGN

The Company's current individual line residential rates are $7.00 per month in the Quartzsite exchange, and $5.50 per month in the Salome exchange, plus mileage and zone charges. Individual business line rates are currently $10.00 in the Quartzsite and $8.50 in the Salome exchange, plus mileage and zone charges.

A. Agreed-to Changes to Rate Design

All parties agree that the rates in the Quartzsite and Salome exchanges should be equalized. In addition, the parties agree that mileage and zone charges should be eliminated, and that current $2.00

charge for Touch Tone service should be removed. We concur with the rate design changes to which the parties agreed.

B. Vacation Rates

The Company has a significant number of seasonal customers, most of whom reside in RV parks when they are in the area. The Company's current tariff provides for a Vacation Rate, whereby seasonal residents can pay the full residential rate for the time they are located in the service territory, and a fifty percent discounted rate for up to eight months while they are away.[6] The Vacation Rate allows customers to maintain the same phone number each season they return to the area, and avoid paying connection charges upon their return. Currently, a seasonal customer in the Salome exchange would pay $9.50 more, over the course of a year, if he were on the Vacation Rate for six months, than if he had to reconnect service for six months. A similar customer in Quartzsite would pay an additional $11 to have the Vacation Rate, rather than reconnecting. The Company proposes to increase its Vacation Rate to $5.00 per month while the customer is out of the area. With the Company's proposed rates, customers would save approximately $4.50 over the year by using the Vacation Rate, rather than disconnecting and then reconnecting service.[7]

RUCO proposed elimination of the Vacation Rate by phasing it out over a three year period. RUCO's witness Dr. Chessler testified that while the cost of providing service during the vacation period is almost identical to the cost of providing service during the rest of the year, Vacation Rate customers generate fewer dollars of toll revenue because they are away for a portion of the year. In addition, Dr. Chessler suggested that seasonal customers may have a greater ability to pay than the average customer, and should not receive discounts at the expense of year-round customers. Dr. Chessler indicated that the Vacation Rates may have been instituted to avoid the costs of subscribers connecting and disconnecting

[6] The Company's witness Mr. Yefchak testified that the appropriate billing for a vacation customer would be six months on the Vacation Rate and six months on the regular rate. The Company's tariff, however, provides that the customer pays the Vacation Rate only for the months he is actually away from the area, up to a maximum of eight months.

[7] None of these comparisons consider the $3.50 per month federal subscriber line charge which cannot be waived during the vacation period. The effect of the charge is to increase the relative savings a customer would obtain by disconnecting rather than using the Vacation Rate.

their lines. RUCO believes, however, that the non-recurring charges for connecting a customer are too low, and that may have caused whatever problem existed.

The Company is concerned that elimination of the Vacation Rate may cause seasonal customers to abandon the Company's services altogether, and rely on cellular phones or other media.

Testimony from the Company's witness, Mr. Daft, suggests that the costs which the Company incurs for a Vacation Rate customer is in fact greater than that for a year-round customer, because of the additional costs to switch the customer between the "home" and "vacation" status. Mr. Daft indicated that the efforts required to switch customers between the "home" and "vacation" status were essentially the same as those required to connect and disconnect a customer, yet customers pay no connection charge when they return to the service area.

RUCO's suggestion that raising the connection charge would decrease the burden on the Company of disconnecting and reconnecting seasonal customers fails to consider that maintaining a year-round connection is impractical for seasonal customers in recreational vehicles. However, year-round customers should not have to subsidize the additional costs to convert seasonal customers between "home" and "vacation" status. To date, seasonal customers have paid a premium for the benefit of maintaining the same phone number upon their return to the area. We will therefore approve a Vacation Rate for the months a customer is away, at a monthly charge of $2.00 more than 1/6 of the total connection charge a seasonal customer would pay to reconnect service upon returning to the area. Over the course of a year, a Vacation Rate customer will pay the same amount as if it were in the area for half the year, and reconnected upon returning, plus a small premium for the benefit of maintaining its phone number from year to year.

C. <u>Public Access Line (PAL) rates</u>

Currently, PAL rates consist of the individual line business rate ($10.00 in Quartzsite, $8.50 in Salome), plus a service charge ($101.00 in Quartzsite, $59.54 in Salome). When the PAL rates were established in 1990, the surcharges were set to recover revenues the Company would theoretically lose when independent payphone providers' phones replaced the Company's payphones.

GCB indicated that, pursuant to the Telecommunications Act and FCC regulations, the PAL rate must be cost based. Therefore, the Company, GCB and RUCO reached an agreement that the PAL rate should be set at the same rate as an individual business line, plus the following additional cost-based charges for additional services: $3.00 for call screening, $2.50 for anti-fraud services and $2.21 for coin supervision. Southwestern's witness Mr. Yefchak testified that the pay telephones can operate off a standard business line. GCB presented evidence that, because of their low usage, the cost to provide a PAL line in the Company's territory are at least equal to, if not lower than, the cost to provide a standard business line.

Staff proposed a PAL rate of $35.00, which is based on its proposed business line rate of $8.50, plus a $26.50 usage charge. Staff believes that the Commission has discretion to determine what is a "cost based" rate, including what constitutes a reasonable allocation of common overhead costs. In addition, Staff represented that FCC regulations permit a small regulated local exchange carrier, like the Company, to mirror the closest price-cap regulated local exchange carrier's PAL rate. Staff argued that its proposed $35.00 PAL rate is lower than the PAL rate of GTE California, the nearest price-cap regulated local exchange carrier.

None of the parties has submitted a cost study to determine the actual costs of the PAL line. Therefore, in light of the low usage of PAL lines in the Company's territory, it is reasonable to substitute the business line rate as a reasonable approximation of the cost of a PAL line. We will therefore adopt the proposal of the Company, GCB and RUCO for pricing PAL lines and related services.

D. Charge for Main Station Phone

The Company proposed that it be permitted to charge $2.00 per month for each customer which uses a Company-provided telephone. The Company has previously provided telephone units to customers at no additional charge. Staff and RUCO opposed the charge for use of the telephone units. We find that any charge the Company makes for such equipment should not be part of the rate design to recover the required revenues. We will require the Company, however, to inform its customers of any charges and that they are not required to use Company-provided telephones.

E. Custom Calling Services

The Company currently charges residential and business customers the same amounts for custom calling features. RUCO proposed that custom calling rates for business be set at 50 percent above the corresponding rates for residential customers. RUCO indicated that the Commission generally sets charges for custom calling features higher for businesses than for residential customers. In addition, RUCO proposed that charges for custom calling features be increased across the board. We believe that it is reasonable that the Company continue charging its business and residential customers equal rates for custom calling features. Maintaining rate equality would avoid customer confusion which would result from initiating a price difference between customer classes for the services. Because we are approving an overall decrease in the Company's revenues, we do not believe that the price for custom calling features should be increased to any customers at this time.

The Company proposed elimination of the $7.00 charge to set up custom calling. RUCO also opposed this change, because the Company does incur costs in setting up the services and RUCO believes that removing the charge would not optimize revenues. The Company testified that it periodically offers promotions waiving the non-recurring charges for custom calling services, and that customers often wait until a promotion to subscribe to the services. We believe that the non-recurring charge should not be eliminated, because the Company does incur costs to set up custom calling features.

In its original application, the Company did not propose rates for Caller ID and Call Rejection. The Company's switches could provide the services within a single exchange, but Southwestern currently lacks the facilities to transmit originating-number information on toll calls. The Company is currently negotiating a contract to obtain the facilities required to provide Caller ID on long distance calls, and expects to begin offering Caller ID services in the near future. The Company believes that offering Caller ID only for local calls would create customer dissatisfaction. However, the Company offered to include Caller ID and related services' revenues, priced at U S WEST's current residential rates. The Company also proposed that the projected expenses to lease the facilities required to offer Caller ID on long distance calls be recovered in rates. The Company projects that it would incur greater expenses to make the services available on toll calls than it would earn in overall revenues. Because we will review Caller ID and related services' costs and proposed charges when the Company files a tariff revision to include the services, we will not include Caller ID services, or additional expenses related thereto, at this time.

F. <u>Alarm Circuits</u>

Currently, the Company charges for alarm circuits on a flat rate basis. The Company proposed to change its rate structure so that alarm circuits are priced on a mileage sensitive rate. The Company's proposed change would result in an overall decrease of approximately 3 percent for alarm circuits. RUCO opposed a decrease for alarm circuit charges overall, although it did not oppose the change in the structure of the rate. RUCO proposed that alarm circuits be priced to recover their full costs, including a markup appropriate for discretionary services, or in the alternative receive the same rate increase as other optional business services. It is reasonable to structure alarm circuit charges on a mileage-sensitive basis as proposed by the Company, with alarm circuits receiving the same overall percentage increase or decrease as other optional business services.

G. Off-premises Extensions

The Company proposed that there be no increase in the charge for off-premises extensions ("OPX"). RUCO proposed that OPX's be charged, on average, no less than the charge for a business line, though the rate structure would be different. Southwestern testified that most of its OPX customers have their extensions provisioned to a garage or other facility on, or very nearby, their property, and that a separate loop is not required for those customers. The Company indicated that when a separate loop is not required the service could be obtained from an electrical contractor rather than from the Company. We do not find the Company's proposal to be unreasonable, given that we are approving an overall rate decrease.

H. Non-recurring Charges

Staff has proposed that certain of the Company's non-recurring charges be consolidated with those of its sister company, Arizona Telephone Company ("ATC"). Staff believes that it is not cost-effective for the Company and ATC to maintain separate tariffs.

We disagree with Staff. There has been no showing that costs at ATC are similar to those of the Company. In addition, absent complete rate consolidation, which Staff has not proposed, separate tariffs would be required, and any efficiencies would be *de minimis*.

I. Rate Schedule

Based on the above-described resolutions of rate design issues, we will require the Company to file a tariff consistent with the rates set forth in Exhibit A attached hereto.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. Applicant is an Arizona corporation engaged in the business of providing telephone utility service to the public in a portion of La Paz, County, Arizona.

2. On January 10, 1997, the Commission received from Southwestern an application requesting authority to increase its rates and charges.

3. On February 10, 1997, Staff determined that Southwestern's application met the sufficiency requirements of A.A.C. R14-2-103 and that the Company had been classified as a Class A utility.

4. In accordance with A.A.C. R14-2-101, a Procedural Order was issued March 9, 1997 which set the matter for hearing on October 9, 1997.

5. In accordance with the Procedural Order, Southwestern published notice of its application for an increase in its rates and charges in newspapers of general circulation in its service areas and mailed, by means of a bill insert, a copy of the notice to each of its customers.

6. By Procedural Order dated October 8, 1997, the Payphone Tariff Filing was consolidated with the rate application.

7. For ratemaking purposes, the Company's OCRB and FVRB for the TY ended March 31, 1996 was $1,673,827.

8. For ratemaking purposes, the Company's adjusted TY revenues were $1,561,191, its TY operating expenses were $1,377,853, and its existing rates provided TY net operating income of $183,338.

9. A fair and reasonable rate of return on the Company's FVRB is 9.438 percent.

10. Operating income of $157,976 is necessary to yield a 9.438 percent rate of return on the FVRB.

11. The Company must decrease operating revenues by $42,096 or 2.70 percent to produce operating income of $157,976.

12. The Company's amended proposed increase of $394,341 would produce an excessive

return on its FVRB.

13. Based on the move toward rate consolidation between the Company's exchanges and the level of revenues authorized herein, the revenue distribution methods described herein, and the rates set forth in Exhibit A attached hereto and incorporated herein, are appropriate in this case.

CONCLUSIONS OF LAW

1. Applicant is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. Sections 40-250 and 40-251.

2. The Commission has jurisdiction over Applicant and of the subject matter of the application and Payphone Tariff Filing.

3. Notice of the application was provided in the manner prescribed by law.

4. In Decision No. 60134 (April 15, 1997), PAL rates were approved, subject to true-up within 180 days. By Procedural Order dated October 8, 1997, the true-up period was extended until the entry of an Order on the rate application.

5. The rates and charges for telephone service proposed by Southwestern are not just and reasonable.

6. The rates and charges authorized hereinbelow are just and reasonable.

7. Southwestern should be authorized to file revised tariffs for telephone service consistent with the above Findings of Fact, the Discussion under Authorized Increase/Decrease and Rate Design, and Exhibit A attached hereto and incorporated herein.

8. Southwestern should true-up its PAL rates charged since April 15, 1997 in its next billing of PAL customers after new rates become effective.

ORDER

IT IS THEREFORE ORDERED that Southwestern Telephone Company be, and hereby is, authorized and directed to file, on or before February 27, 1998, revised tariffs setting forth the rates and charges for the provision of telephone service authorized herein and in accordance with the Discussion, Findings of Fact and Conclusions of Law herein, and Exhibit A attached hereto and incorporated herein.

IT IS FURTHER ORDERED that the rates and charges contained in said tariffs shall become effective for all service provided on and after March 1, 1998.

IT IS FURTHER ORDERED that Southwestern Telephone Company shall notify its customers of the rates and charges authorized hereinabove and the effective date of same by means of an insert in its next regular monthly billing.

IT IS FURTHER ORDERED that the above notice shall also include, in bold type, information indicating that customers are not required to use main station telephone equipment provided by Southwestern Telephone Company, and that any charges by Southwestern Telephone Company for customer premises equipment are not set by the Commission.

IT IS FURTHER ORDERED that Southwestern Telephone Company shall true-up PAL rates charged customers since April 15, 1997 to the rates approved herein by refund or surcharge in equal increments over the next ten months.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

COMMISSIONER - CHAIRMAN	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I, JACK ROSE, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ______ day of __________, 1998.

JACK ROSE
EXECUTIVE SECRETARY

DISSENT ______________
SSW:dap

SERVICE LIST FOR: SOUTHWESTERN TELEPHONE COMPANY

DOCKET NO.: T-01072A-97-0067 ET AL.

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EXHIBIT A

JIM IRVIN
COMMISSIONER - CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

JACK ROSE
EXECUTIVE SECRETARY

ARIZONA CORPORATION COMMISSION

January 23, 1998

TO ALL PARTIES:

Please find enclosed the Exhibit A for Docket No. T-01072A-97-0067 (Southwestern Telephone Company) to be attached to the Recommended Opinion and Order that was mailed to you on January 21, 1998.

Sincerely,

Scott S. Wakefield
Hearing Officer

1200 WEST WASHINGTON. PHOENIX, ARIZONA 85007-2996 / 400 WEST CONGRESS STREET TUCSON ARIZONA 85701-1347

EXHIBIT A

Class of Service	Commission Authorized Rate
Residential Local Exchange Access Service:	
(Quartzsite and Salome Exchange)	
Individual Line Primary Service	$6.46
Individual Line Primary Service Vacation	$4.50
Two-Party Line Primary Service	$4.99
Two-Party Line Primary Service Vacation*	$3.47
Business Local Exchange Access Service:	
(Quartzsite and Salome Exchange)	
Individual Line Primary Service	$9.99
Individual Line Primary Service	$9.99
Two-Party Line Primary Service	$9.99
Semi-Public Phone	$9.99
Semi-Public Phone Minimum Daily Rate	$0.00
COPT (B-1 rate)	$9.99
COPT Service Usage	$0.00
Private Branch Exchange Service-Trunk Line	$38.35
Optional Services:	
(Both Exchanges)	
Custom Calling:	
CCS-Call Forward	$3.00
CCS-Call Forward Vacation	$0.00
CCS-Call Waiting	$3.00
CCS-Call Waiting Vacation	$0.00
CCS-Call Conference	$3.00
CCS-Call Conference	$3.00
CCS-Call Conference	$3.00
CCS-Speed Call 8	$2.00
CCS-Speed Call 8 Vacation	$0.00
CCS-Speed Call 30	$4.00
CCS-Call Hold	$1.50
CCS-Toll Restriction	$2.00
Touch Tone	$0.00
Touch Tone Vacation	$0.00
Touch Tone	$0.00
Touch Tone	$0.00
Directory Listings - Both Exchanges:	
Additional Directory Listing Business	$1.00
Additional Directory Listing Business Vacation	$0.00
Additional Directory Listing Residence	$1.00
Additional Directory Listing Residence Vacation	$0.00
Reference to Service -Same Subscriber	$1.00
Reference to Service -Other Subscriber	$1.25
Additional Information to Listing	$1.00
Non-Listed Numbers	$1.25
Non-published Numbers	$1.25
Foreign Directory Listing - First Line	$2.30
Foreign Directory Listing - Additional Lines	$2.30

Class of Service Miscellaneous Service Arrangements: (Both Exchanges)	Commission Authorized Rate
Off Premises Extension Mileage Contg, 1/4 Mile	$1.00
Off Premises Extension Mile Non Contg, 1/4 Mile	$2.00
Off Premises Extension Mile NonContg,Add'l 1/4	$1.00
Mobile to Land Service (per min.) Contract	$0.00
DID-First Block of 100 Numbers - Contract	$0.00
DID-ADD Block of 100 Numbers - Contract	$0.00
DS-1 Trunk Facilities	$110.00
DS-1 Trunk Termination	$125.00
DS-1 Trunk Channelization	$150.00
Control Access Register	$5.00
Direct Inward Dial Number (200 Numbers)	$17.50
MTL Interconnection MOU Rate	$0.05
Alarm Circuit	$0.00
Alarm Circuit	$0.00
Alarm Circuit	$0.00
Alarm Circuit - Local Channel Mil. 1st 1/4 mile	$8.35
Alarm Circuit - Local Channel Mil. Add'l 1/4 mile	$2.10
Key Hunting	$5.00
Call Screening	$5.00
Call Blocking	$5.00
Inside Wire Maintenance Service	$1.25
(Both Exchanges)	
Service Order, Line Connection Business	$15.00
Service Order, Line Connection Residence	$15.00
Service Order, Line Installation	$20.00
Service Order,Subsequent	$5.00
Central Office Connect	$10.00
(Both Exchanges)	
Call Forwarding Installation	$7.00
Call Waiting Installation	$7.00
Speed Dial 8 Installation	$7.00
Speed Dial 30 Installation	$15.00
Touch Tone Installation	$0.00
NSF Return Charge	$15.00
Reconnect for Non-pay	$15.00
Service Order Reconnect	$0.00
Number Change Charge	$0.00
Directory Listing Change	$0.00
Toll Restriction Installation	$0.00
Special Service Connect	$0.00
Service Order Charge - Inside Move/Change	$0.00
Service Order Charge - Outside Move/Change	$0.00
Equipment Lease and Services: (Both Exchanges)	
Business Extension Phone (Salome)	$2.00
Business Extension Phone (Quartzsite)	$2.00
Residence Extension (Salome)	$2.00
Residence Extension (Quartzsite)	$2.00
Residence Extension Vacation (Salome)	$0.00
Residence Extension Vacation (Quartzsite)	$0.00
Premier 2 Line Extension (Quartzsite)	$2.00
Premier 2 Line Extension (Salome)	$2.00
Loud Ringing Gong Local Service	$1.50
Trendline Telephone	$1.75
Extension Bell	$1.25
Extension Bell Vacation	$0.00
Single Line Hold Button	$1.25
Transfer Key Local Service	$1.25
Service Connect - Off Premise	$0.00
Service Charge - Change Telephone Number	$0.00
Extension Jack Connect Charge	$0.00